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Background

August, 1983

U.S. BUSINESS OUTLOOK SHORT-TERM

Executive Summary

The consumer finally did it. She/he boosted spending a bundle in 1983's second quarter with the result that economic growth zoomed at a 9.2% annual rate--the fastest quarterly pace in five years.

Another pillar of growth in the second quarter was residential construction, which has been surging for nearly a year. But because mortgage rates have moved up of late, housing may be in some trouble. Rising interest rates may also cause consumer spending to power down, since the big buying spree has been focused on durable goods that are often purchased on credit.

If housing and consumer spending are slowing down, what will happen to the recovery?

Fortunately, at least in the short run, the recovery seems safe for several reasons. One is that with incomes rising the level of consumer spending should rise, even if the pace slows.

Another reason is business investment in capital equipment. After sinking precipitously for nearly two years, capital equipment began a small recovery early this year and then surged in the second quarter. Because corporate cash flow is increasing smartly and because firms are



expected to cut costs through automation, capital equipment investment should help power the economy into 1984.

Rebuilding of inventories should also spur continued economic growth. With the inventory-to-sales ratio at a historic low, firms will have to restock or risk losing sales.

A threat to the recovery does, however, loom--high interest rates, kept high by massive federal deficits. Because business demand for external funds is usually modest in the initial stages of economic expansion, though, the U.S. Treasury should be able to raise record amounts through the rest of 1983 without forcing interest rates up. Next year, however, as business seeks more funds, interest rates could begin a sustained rise, putting the economy in jeopardy. The forecast, though, assumes that inventory building, plant and equipment outlays, and consumer spending will carry the economy upward through the end of 1984.

Toting up all these pluses points to inflation-adjusted growth of 3% this year and 4.5% next year. The forecast is pictured in the graph below.

